Abstract: Few purchases during one's lifetime will be as expensive as buying a home. That's why, when considering a mortgage, it's important to know what specific type of loan is the best choice. This article looks at the two major choices: fixed-rate and adjustable-rate.

Which type of mortgage loan meets your needs?

Few purchases during your lifetime will be as expensive as buying a home. Whether it's your primary residence, a vacation home or an investment property, how you choose to pay for it can have a significant impact on your financial situation over time. If you're considering a mortgage loan, understanding the main categories of mortgages — fixed-rate and adjustable-rate — and the situations they're best designed for will help you match the right type for your needs.

Fixed-rate loans offer stability

A fixed-rate mortgage, as its name suggests, is a loan whose interest rate remains constant for the life of the loan — typically 15 or 30 years. One of the primary benefits of a fixed-rate loan is that it provides a measure of certainty about one of the biggest expenses in your monthly budget. With interest rates likely to rise after an extended period of historically low rates, you won't have to worry about potentially higher payments in the future if you select a fixed-rate loan.

That said, if interest rates were to fall again, your fixed-rate loan would leave you unable to take advantage of the shift unless you refinance, which might involve fees. You're also paying a premium for the stability offered by a fixed-rate mortgage. You could consider a 15-year fixed-rate loan, which would charge a lower rate than a 30-year loan, but the tradeoff will be higher monthly payments.

ARMs provide flexibility

Adjustable-rate mortgages (ARMs) typically offer a fixed interest rate for an initial period of years. This rate, which is usually lower than that of a comparable fixed-rate mortgage, resets periodically based on a benchmark interest rate. For example, a 5/1 ARM means that your interest rate is fixed for the first five years and then will adjust every year after that.

Paying less interest in the beginning frees your cash for other investments. You might also take advantage of an ARM if you're confident that you'll have more money in the future than you do today, or if you plan on selling your house before or soon after the initial fixed-rate period expires. When considering an ARM, you'll need to assess your ability to keep up with potentially higher payments — say, if the initial period expires, your rate goes up and you're unable to sell the home, or if your income changes.

The best for you

The right loan type depends, naturally, on your financial position. But whether you're buying a primary residence, vacation home or investment property also plays a role. Regardless of which type of home you're purchasing, having a basic knowledge of the loan types can help ease the buying process. Let our firm assist you in evaluating the best mortgage for your needs.